IN THE HIGH COURT OF KARNATAKA AT BANGALORE

Dated this 16th day of March 2009

PRESENT

The Hon'ble Mr. Justice K Sreedhar Rao

And

The Hon'ble Mr. Justice C R Kumaraswamy

ITA No.3021/2005
C/w
ITA Nos.3022/2005 to 3025/2005

BETWEEN

JINDAL THERMAL POWER COMPANY LTD
(EARLIER KNOWN AS JINDAL TRACTEBEL POWER COMPANY LTD)
707, BARTON CENTRE, M G ROAD, BANGALORE ALSO AT
RAHEJA TOWERS, EAST WING 6th FLOOR, 26-27, M G ROAD
BANGALORE-560001 …….. APPELLANT (COMMON)

(By: Shri Suhail Dutt with Shri T S Venkatesh, Adv)

Vs

DEPUTY COMMISSIONER OF INCOME TAX
(TDS), BANGALORE ……. RESPONDENT (COMMON)

(By : Shri Mohan Parasaran, ASG for Sri M V Seshachala, Senior Standing Counsel)

COMMON JUDGEMENT

All the appeals pertain to same subject matter involving similar questions of law and fact. Hence, all the appeals are heard together for common disposal. The material facts are as under:

M/s. Jindal Thermal Power Company Limited (Jindal) (appellant in all the appeals) entered into contract with Raytheon - Ebasco Overseas Ltd., (REOL) and other three companies viz., 1) BHEL, 2) Energy Overseas International Inc. (EOI) and 3) Badger Energy Inc. (BEI) for commissioning of power plant at Thorangal, Beilary District. The companies BEI & EOI are the subsidiary companies of REOL. BHEL is a Government of

India undertaking. Jindal entered into four separate contracts with REOL, BHEL, BEI and EOI. BHEL under the contract obliged to supply of Boilers, steam turbine Generators, main power transformers and process piping.

The BEI Under the contract is obliged to local services, construction of all BHEL supply, startup and commissioning. The obligation of EOI under the contract is to collect and purchase local material equipment supply and construction of all REOL and local supply. The REOL under the contract has the obligation of Off-shore services which includes conceptualization of the project, designs, drawings and other technical aspects for commissioning and to make the project operative. The REOL also must supply equipment and material supply. The remuneration for services to be rendered by BHEL, BEI & EOI is separately agreed under the contract. The remuneration to be payable to REOL under the contract is under three categories:

1) TECHNICAL SERVICES:

The Technical Services to be provided under the REOL were to be rendered entirely outside India and includes the following services:

i) Providing engineering and design work relating to conceptualisation of the power plant, i.e., overall Power Plant design,

ii) Providing specification of all material for the Power Plant, based on, the overall design including the specific requirements developed as part of the overall design,

iii) Providing suppliers quotations and document reviews to enable compliance with specifications developed by REOL for the Power Plant,

iv) Supplying drawing reviews to enable integration of the equipment to be supplied to Jindal into the overall Power Plant design, and

v) Undertaking preparation of final documentation of the design of the plant and equipment necessary for Power Plant.

2) START UP SERVICES:

The nature of Start-up Services to be provided by REOL primarily relates to what is known as home office start-up support. Accordingly, REOL's home office in the US would indicate in detail the procedures of start up to be carried out on site by the start up contractor, an entity different from REOL. The Start-up Services provided by REOL under the Contract includes the following:

i) Development of scoping Packages whereby the various instrumentation, electrical, mechanical and equipment, listings were drawn up and were further broken down into sub-systems for the purpose of commissioning by the start up contract;

ii) Laying out of test procedures for the various subsystems, systems, equipment and components, contained in detailed instructions in the form of manuals are made available to start up contractor who is required to follow the given instructions (The start up contractor has no authority whatsoever to deviate from the instructions given by REOL and should any change be required the same has to be approved and duly authenticated by REOL only); and

iii) The presence of the vendor or their representatives in India during the startup process should the equipment supplied by the vendor be not in a position to be commissioned.

3) OVERALL RESPONSIBILITY:

As is generally the case in most large projects, the overall responsibility and management of the project, has been agreed to be undertaken by REOL. These services include the following:

i) the overall management of the project,

ii) the overall project risk management and coverage,

iii) providing completion guarantees, plaint performance guarantees for net plant output and efficiency,

iv) providing extended mechanical warranties provided to JINDAL, beyond the standard guarantees provided by the equipment suppliers,

v) managing the project by interfacing with the other contractors on the job site, on a daily basis, through phone calls and faxes, and

vi) reviewing weekly and monthly status reports issued by the other contractors to REOL for its review and action.

2. The JINDAL while making payments to REOL under the contract for the assessment year 1996-97 initially deducted part of the tax liability by way of TDS. For the assessment year 1997-98 no TDS deductions are effected. It is the contention of the appellant that, the initial remuneration agreed to be payable by the REOL under the contract for technical services 28,270,000 USD, for Start up Services 7,406,325 USD and for Overall Responsibility 14,106,333 USD. The contract value for Technical Services modified to 14,484,560 USD, for Start up Services 6,235,325 USD and for Overall Responsibility 10,724,651 USD.

3. The Assessing Authority issued Notice to JINDAL calling up to pay tax in respect of the remuneration paid to REOL. Since the JINDAL had not effected TDS as required under law.

Therefore, the Jindal was fixed with responsibilities to make the tax payment on the account of the REOL.

4. The Jindal pleaded before the Assessing Authority that the payments made to REOL does not attract any tax liability as such there was no duty on the part of the Jindal to effect TDS.

The Assessing Authority rejected the contention and directed the Jindal to make payment of tax on the account of REOL. In the appeal filed by Jindal, CIT rejected the contention of the Jindal and held that the payments made to REOL attracts tax liability u/s 9(1)(vii)(c) of the I.T. Act, Since the income is accrued in India and the services are utilised in India. The CIT also rejected the contention that services of REOL would not come within the ambit of Article 12(5) of DTAA (Double Taxation Avoidance Agreement). The order of the assessing Authority is confirmed and the appeal of Jindal is rejected.

The Jindal before CIT and ITAT (Income Tax Appellate Tribunal) had canvassed the following grounds to challenge the order of assessment:

1) The Jindal is not liable to affect TDS in the payments made to the REOL because the services rendered by REOL would not come with the purview of Sec. 9(1)(vii)(c). In order to attract tax liability, it is essential that the services by Non-resident company (NRC) should have rendered in India and utilised in India.

In the instant case, the technical services are not rendered in India, although the services are utilised in India. In this regard the decision of Supreme Court in Ishikawajma Harima Heavy Industries Ltd., V/s. Director of Income Tax, Mumbai reported in (2007) 3 SCC 481 is relied on.

(2) In the alternative it was contended that the technical services rendered are ancillary and subsidiary "as well as inextricably and essentially linked to the supply of property". Therefore, under Article 12(5) of DTAA the payments made of REOL are fully exempt.

The CIT & ITAT had decided the appeals on plain interpretation of the provisions of Section 9(1)(vii)(c) of I.T. Act and at that point of time the decision of the Supreme Court in Ishikawajma Harima Heavy Industries Ltd., case was not yet rendered.

On the alternate contention it was held that, the Jindal has not produced the custom payment receipts to prove that the technical services rendered by REOL was part of the price of the equipment and machinery imported. In the absence of such evidence, it was held that technical services rendered do not constitute part of the cost price. The remuneration towards technical services is distinct and independent from the cost price.

6. Heard Sri. Suhail Dutt, counsel for Jindal and Sri. Mohan Parasaran on the facts and law involved in the case. On considering the submissions at the bar, the following points would arise for consideration:

1) Whether the payments made to REOL attracts tax liability u/s 9(1)(vii)(c) r/w Explanation to Sec. 9(2) of the I.T. Act and whether the Jindal was obliged to effect TDS in the payments made to REOL u/s 195 of the I.T. Act?

2) Whether the services rendered by REOL are ancillary and inextricably mixed with the cost of the equipment supplied; as such the payment is exempt under Article 12(5) of the DTAA?

3) Whether the Jindal has locus-standi to file the appeals against the orders in question?

The provisions of Sec. 9(1)(vii)(c) and explanation to Sec. 9(2) of I.T. Act are extracted hereunder:

"9 - Income deemed to accrue or arise in India: -

(1) The following incomes shall be deemed to accrue or arise in India

(vii) Income by way of fees for technical services payable by -

(a) x x x

(b) x x x

(c) a person who is a non-resident, where the fees are payable in respect of services utilized in a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India.

9(2) xxxx xxxxx xxxx

Explanation- For the removal of doubts, it is hereby declared that for the purpose of this erection, where income is deemed to accrue or arise in India under clauses (v),(vi) and (vii) of sub-section(1), such income shall be included in the total income of the non-resident, whether or not the non-resident has a residence or place of business or business connection in India.

Sri. Mohan Parasaran referred to Memorandum explaining the provisions in The Finance Bill, 2007 relating to the explanation incorporated to Sec. 9(2) of the Act. The relevant material in the Memorandum is extracted hereunder:

RATIONALISATION AND SIMPLIFICATION MEASURES, Income deemed to accrue or arise in India Section 9 provides for situations where income is deemed to accrue or arise in India.

Vide Finance Act, 1976, a source rule was provided in the said section through insertion of clauses (v), (vi) and (vii) for income from interest, royalty or fees for technical

services. It was provided inter alia, that in case of payments of interest, royalty or fees for technical services received from a resident payer income would be deemed to accrue or arise in India, except where the interest or royalty or fees for technical services are relatable to a business or profession carried on by the resident payer outside India or for making or earning any income from any source outside India. xxxxxx xxxx (not legible for typing) irrespective of the situs of the services, the situs of the payer and the situs of the utilisation of services will determine the tax jurisdiction. Further, Section 5, which defines scope of total income, is subject to other provisions of the Act, which would include section 9, and the income deemed to accrue or arise in terms of section 9 gets covered under section 5, income does not have to actually accrue or arise in India to be deemed to accrue or arise in India.

Sri. Mohan Parasaran argued that the explanation incorporated by way of amendment to Sec. 9(2) is to overcome the legal lacuna pointed out by Supreme Court in Ishikawajma's case. It is submitted that after incorporation of Sec. 9(2), it is no longer necessary that the criterion of rendering of service in India is to be established. It is suffice for attracting the tax liability, if the services are utilised in India. In such case the income is deemed to accrue in India.

Sri. Mohan Parasaran relied on the decision of the Bombay. High Court in Commissioner of Income Tax V/s Siemens Aktiongesellschaft reported in Manupathra MANU/MH/1271/2008 (2008) 220 CTR (Bom) 425 to contend that the explanation incorporated to Section 9(2) has done away with the ratio laid down by the Supreme Court in Ishikawajma's case.

On facts, it is submitted that, the BEI & EOI are the subsidiary companies of REOL. Despite separate and independent contract of BEI and EOI with Jindal, the terms of contract categorically indicate that the said companies were acting only as agents of REOL in successful erection of the plant. The terms of contract provided that the BEI & EOI had no independent discretion in the process of erection and implementation of the project. The representative of the REOL was to make periodical visits to oversee the work done by BEI and EOI. It is also, stipulated that the representative has the responsibility of overseeing the proper co-ordination of all the agencies involved. The contract stipulates that the REOL has the over all turn key responsibility. It is therefore, argued that whatever work executed by REOL through its agent BEI and EOI is deemed to have rendered service in Indian and utilized in India by Jindal. Thus supported the order of the ITA in fastening the tax liability on Jindal in respect to the payments made to REOL.

It was strenuously contended that the CIT & ITAT have unequivocally held that the Jindal has suppressed the documents relating to payment of customs duty for the material import. The contention that technical services rendered by REOL inextricably forms part of the cost price of the equipment is rightly rejected, because the custom duty receipts are produced to prove the contention. In that view, it is rightly held that Jindal is not entitled to benefit under Article 12(2) of the DTAA. That apart, it is submitted that Article 12(2)

does not envisage total exemption. Hence, even according to DTAA the Jindal cannot escape the liability to pay Tax in respect of the payments made to REOL.

The decision of the Supreme Court in The Aggarwal Chamber of Commerce, Ltd., V/s. Ganpat Rai Hira Lal reported in online Manupathra ANU/SC/0054/1957 and the decision in The Transmission Corporation of A.P. Ltd., & Anr v/s. The Commissioner of income Tax, A.P. reported in online Manupathra MANU/SC/0483/1999 to contend that Jindal has no right of appeal. The primary liability to pay tax is on REOL. It is the REOL who has the right in law to challenge the order as an assessee. The Jindal was only to effect TDS.

The Jindal has no representative capacity and cannot litigate proxy for REOL.

The decision of the Bombay High Court in Vodafone International Holdings B.V., V/s. Union of India, Ministry of Finance, New Delhi is relied on to contend that when there is suppression of material documents an adverse inference be drawn against the party who has suppressed the documents. In this regard, it is submitted that the custom duty documents have been suppressed. Therefore an adverse inference should be drawn against Jindal.

Per contra, Mr. Suhail Dutt, counsel for Jindal relied upon the decision of the Bombay High Court in Clifford Chance V/s. The Deputy Commissioner of Income Tax online Manupathra MANU/MH/1217/2008 to contend that the ratio of Supreme Court in Ishkawajma's case regarding twin criteria of rendering of service in India and its utilization in India has not been done away with by the incorporation of explanation to Sec. 9(2). The explanation makes it clear that the tax liability is subject to the provisions of Sec. 9(1)(vii)(c).

Thus the twin requisites laid down by the Supreme Court in Ishkawajma's case still holds the field. The memorandum explaining the provisions although declares that the explanation is incorporated to overcome the decision of the Supreme Court. However, submitted that the objects and reasons stated are only external aids to be used only when the text of the law is ambiguous. In the instant case it, is argued that the explanation incorporated does not offer any ambiguity to seek the assistance of external aids. The plain reading of the provision makes it unequivocal that position of tax liability clarified in the explanation is subject to the provisions of Sec. 9(1)(vii)(c).

The counsel for Jindal referred to the observations made in para-11 of the judgment of the Supreme Court in Commissioner of Income Tax, West Bengal V/s Wesman Engg Co (P) Ltd. reported in AIR 1991 SC 570 and the provisions of Sec 195 and 201 r/w Sec. 246(i) and 248 of I.T. Act to substantiate the contention that the Jindal has right of appeal in the matter, although it pertains to the tax liability of REOL.

On the question of locus-standi, the ratio laid down in the decision of the Supreme Court in Aggarwal Chamber of Commerce case has no application to the facts on hand. The facts in the cited case disclose that the firm went into liquidation. While accounting the

amounts to the Liquidator the appellant had effected TDS. Official Liquidator insisting payment without effecting TDS. In the context of said facts it is held that deducting the TDS from the payment is justified. The question of tax liability is essentially an issue between the assessee on whose account TDS effected and the revenue.

In the case of Transmission Corporation of AP Ltd case it is laid down that there a liability on the assessee to effect TDS in respect of the payments made to others. In para-14 of the judgment following observations are made:

"In this view of the mater the High Court has given decision that, (i) the assessee who made the payments to the three non-residents was under the obligation to deduct tax at source under Section 195 of the Act in respect of sums paid to them under the contract entered into; and (ii) the obligation of the respondent assessee to deduct tax under Section 195 is limited Only to appropriate proportion of income chargeable under the Act are correct."

The decision however does not lay down that the person is obliged to effect TDS u/s 195 has no right to question the assessment of tax liability. Since in law, if TDS is not effected by the payer (Jindal), the payer would be ultimately responsible to pay the tax liability of the payee (REOL). The conjoint reading of Section 195, 201 read with Section 246(1)(i) and Section 248 makes it clear that the Jindal as a payee has every right to question the tax liability of its payee to avoid the vicarious consequences. Therefore the contention that Jindal has no right of appeal is to be rejected.

The explanation incorporated in Sec. 9(2) declares that "where the income is deemed to accrue or arise in India under clauses (v), (vi), (vii) of sub-Sec.(1), such income shall be included in the total income of the non resident; whether or not the resident has a residence or place of business or business connection in India." The plain reading of the said provision suggests that criterion of residence, Place of business or business connection of a nonresident in India has been done away with for fastening the tax liability. However, the criteria of rendering service in India and the utilisation of the service in India laid down by the Supreme Court in Ishikawajma's case to attract tax liability u/s 9(1)(vii) remains untouched and unaffected by the explanation to Sec. 9(2).

When the purport of the explanation to Sec. 9(2) is plain in its meaning, it is unnecessary and impermissible to refer to the Memorandum explaining the Finance Bill 2007. Therefore, it is explicit from the reading of Sec,. 9(1)(vii)(c) and explanation to Sec.9(2) that the ration laid down by the Supreme Court in Ishikawajma's case still holds the field.

On facts we find that in respect of "start up services and over all responsibility" the part of the technical services although rendered partly of shore but the execution of the work even though done by BEI and EOI, however the same is carried out under the direct supervision of REOL. The BEI and EOI, although hold independent contract with Jindal, as per the terms of the contract they execute the work under direct control and supervision of REOL. Hence, BEI and EOI virtually constitute the executive agents of

REOL. In that view, the REOL under the contract, takes the over all responsibility for the successful erection and operation of the plant.

The contract has three aspects: The first aspect deals with the technical services. The rendering of technical services basically involves over all conceptualization of the plant, the technical logistics and designs etc., which is more in the nature of a theoretical formulation of the project. In this regard the subsidiaries the BEI and EOI have no role to play. Their job is essentially the executory part of the contract. The rendering of theoretical aspects of technical services could be done wholly of-shore and outside India. Therefore, the first aspect of the contract viz., technical services could be contra distinguished from the "start up services and over all responsibility." In respect of later two, it can be said that the REOL is equally involved in executory part of the contract. Therefore, the twin criterion of rendering of services in India and utilisation of services in India becomes evidently noticeable in respect of "start, up services and over all responsibility." However, in respect of "technical services" the rendering of services being purely of-shore and outside India, the remuneration whatever paid towards technical services does not attract tax liability. However, the split up remuneration paid towards "start up services and over all responsibility", the Jindal had duty in law to effect TDS. The failure to do so makes Jindal vicariously liable to pay the tax on the amounts paid to REOL towards, "start up services and over all responsibility." However, the Jindal would not incur any liability to pay tax towards the amount paid in respect of "technical services." The Jindal would be entitled to refund of Tax in respect of payment made to REOL towards "technical services."

The Jindal has not produced the custom duty documents to show that the amounts paid to REOL in respect of "technical services, startup services and over all responsibility" forms part of the cost price of the equipment. Therefore, the ITAT has rightly held that Jindal is not entitled to benefit under Article 12(2) of the DTAA. Accordingly, the appeals are partly allowed in the terms indicated above.

Sd/- Judge

S/d- Judge